DEPARTMENT OF STATE REVENUE

01-20210088R.SLOF

Supplemental Letter of Findings: 01-20210088R
Indiana Individual Income Tax
For the Tax Year 2019

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Supplemental Letter of Findings.

HOLDING

On rehearing, the Department again concluded that Out-of-State Individuals had not established that they were entitled to offset their Indiana gambling winnings against their gambling losses as ordinary and necessary business expenses; in the absence of evidence that Individuals played poker in a "business-like" manner, the Department found that Individuals were recreational gamblers under the federal "hobby income" regulations.

ISSUE

I. Indiana Adjusted Gross Income Tax - Professional Gambler Status.

Authority: IC § 6-8.1-5-1; IC § 6-3-1-3.5; 45 IAC 3.1-1-1; IC § 6-3-2-2(a); I.R.C. § 62; I.R.C. § 165; Treas. § Reg. 1.183-2; *C.I.R. v. Groetzinger*, 480 U.S. 23 (1987); *Higgins v. Commissioner of Internal Revenue*, 312 U.S. 212 (1941); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Popovich v. Indiana Dept. of State Revenue*, 52 N.E.3d 73 (Ind. Tax Ct. 2016); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Ferguson v. C.I.R.*, T.C. Summ. Op. 2007-30, 2007 WL 610059 (2007); *Busch v. Commissioner of Revenue*, 713 N.W.2d 337 (Minn. 2006); *Golanty v. Commissioner*, 72 T.C. 411 (1979); Letter of Findings 01-20210026R (March 12, 2021).

Taxpayers argue that the Department erred when it determined that they were not entitled to offset their Indiana gambling winnings against their Indiana gambling losses as ordinary and necessary business expenses.

STATEMENT OF FACTS

Taxpayers are out-of-state individuals who filed a joint 2019 IT-40 PNR ("Part-Year or Full-Year Nonresident") Indiana income tax return. On that return, Taxpayers reported Indiana source income primarily attributable to gambling activity.

The Indiana Department of Revenue ("Department") reviewed the 2019 return. The Department determined that Taxpayers were not "professional gamblers" and thereby not entitled to claim a deduction based on the total amount of 2019 "losses" incurred at the Indiana casino.

The Department's conclusion resulted in an assessment of $500 in Indiana income tax on the total winnings and the denial of an approximately $200 refund request originally claimed on that Indiana return.

Taxpayers disagreed with the adjustment and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayers' representative explained the basis for the protest. A Letter of Findings ("LOF") was issued on March 12, 2021, in which Taxpayers' protest was denied on the ground that they failed to establish that they were professional gamblers entitled to the tax treatment they sought.

Taxpayers disagreed with the Department's decision, asked for, and were granted a rehearing on the ground that the March LOF incorrectly analyzed both the facts and the application of the law.

A telephone rehearing was scheduled for May 11, 2021, in order to provide Taxpayers an additional opportunity to explain their arguments. Taxpayers failed to take part in this second hearing; this Supplemental Letter of Findings is based upon Taxpayers' rehearing request and the documents provided at the time of the original protest.

I. Indiana Adjusted Gross Income Tax - Professional Gambler Status.

DISCUSSION

The issue is whether husband and wife Taxpayers have provided sufficient information to establish that they are "professional" gamblers entitled to offset their total Indiana gaming losses against their total Indiana gaming winnings.

A. Reporting Indiana Gambling Winnings and Losses.

IC § 6-3-1-3.5 states as follows, "When used in IC § 6-3, the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code) . . . ." Thereafter, the statute specifies addbacks and deductions, peculiar to Indiana, which modify the federal adjusted gross income amount. The Department's regulation concisely restates the formulary principal. 45 IAC 3.1-1-1 defines individual adjusted gross income as follows:

> For individuals, "Adjusted Gross Income" is Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:
>
> (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
>
> (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
>
> (3) Make all modifications required by IC 6-3-1-3.5(a). *See also* IC § 6-3-2-2(a) (Apportioning to Indiana income earned by non-residents).

Both the statute, IC § 6-3-1-3.5, and the accompanying regulation, 45 IAC 3.1-1-1, require that an Indiana taxpayer employ the Federal adjusted gross income calculation, as determined under I.R.C. § 62, as the starting point for determining the taxpayer's Indiana adjusted gross income.

I.R.C. § 62 states that, "For purposes of this subtitle, the term 'adjusted gross income' means, in the case of an individual, gross income minus the following deductions . . . ." The deductions specified under I.R.C. § 62 contain no provision permitting an individual to deduct gambling losses from his or her gross income. However, the federal law does permit the deduction of gambling losses to the extent of a taxpayer's gains from similar transactions. I.R.C. § 165(d).

> [Professional Gambling] expense deductions . . . are above-the-line deductions made pursuant to the provisions of the Internal Revenue Code and the related U.S. Treasury Regulations in determining federal adjusted gross income. *Popovich v. Indiana Dept. of State Revenue*, 52 N.E.3d 73, 79 (Ind. Tax Ct. 2016).

B. "Professional" Gamblers and Recreational Gamblers.

Tax reporting by a professional gambler is different from that of a recreational gambler. A recreational gambler can report losses only to the extent of gains from gambling activity. The recreational gambler reports winnings as part of adjusted gross income and may report losses only if deductions are itemized. The professional gambler is not required to report losses as an itemized deduction. Instead, losses and gains are reported on Schedule C. The net gain or loss is then reported on Form 1040 prior to arriving at adjusted gross income as an above-the-line deduction. This typically causes the professional gambler's adjusted gross income to be lower than that of the recreational gambler because the professional gambler is able to deduct "necessary and ordinary" business expenses from gambling gains.

Determining whether a taxpayer is a professional gambler - is engaged in a "trade or business" - or whether the taxpayer is simply a recreational gambler is determined under I.R.C. § 183 which are the "hobby loss" rules.

Treas. Reg. § 1.183-2 provides a "non-exhaustive list of factors to be *weighed* when determining whether a taxpayer was engaged in gambling with the objective of making a profit." *Popovich*, 52 N.E.3d at 79 (*emphasis in original*). Treas. Reg. § 1.183-2(b). The regulation's factors include:

- The manner in which the taxpayer carries on the activity including whether the taxpayer carries on the activity in a "businesslike manner and maintains complete and accurate books;

- The expertise of the taxpayer including whether the taxpayer prepares for gambling "by extensive study";
- The time and effort spent by the taxpayer in carrying on the activity;
- The expectation that the money spent gambling may result in profit;
- The success of the taxpayer in carrying on the gambling activity;
- The taxpayer's history of gambling winnings and losses;
- The amount of any profits from gambling;
- The financial status of the taxpayer. Does the taxpayer have "income or capital from sources other than the [gambling] activity";
- The relative elements of "personal pleasure or recreation" attributable to the gambling activity. See also *Popovich*, 52 N.E.3d at 79.

Taxpayers argued that they were entitled to claim professional gambling status, but the Department disagreed and concluded that - based "on the best information available" - they are engaged in gambling as a recreational "hobby."

C. Taxpayers' Burden of Establishing that the Department's Decision was Wrong.

As with any assessment, it is Taxpayers' responsibility to establish that this particular $500 tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Furthermore, the Department bears in mind its statutory responsibility under IC § 6-8.1-5-1(b) which states that if it "believes that a person has not reported the proper amount of tax due, the department *shall* make a proposed assessment of the unpaid tax on the basis of the best information available to the Department." (*Emphasis added*).

In making their case, each taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, informed and reasonable interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

The original LOF found that Taxpayers had failed to meet their statutory burden of establishing that they were entitled to calculate and report their Indiana income as "professional gamblers." As explained in the original LOF:

> The Department is in no position to question anyone's intentions or how they spend their money, but there is little evidence that Taxpayers played casino games and maintained gaming records in a "businesslike manner," that they prepared to gamble by undertaking "extensive study," or that they had an actual and realistic expectation that the Indiana casino could reasonably be relied upon to provide their livelihood. Letter of Findings 01-20210026R (March 12, 2021).

D. Taxpayers' Arguments.

Taxpayers originally pointed out that they made a $15,000 profit by gambling at an Indiana casino. Taxpayers maintain that the mere fact that they made a gambling *profit* would tend to show that they were professional gamblers. In addition, Taxpayers provided their W-2G ("Certain Gambling Winnings") detailing their winnings at an Indiana casino.

In their rehearing request, Taxpayers questioned the LOF's analysis that Taxpayers could not "realistically rely on their $15,000 in winnings to maintain their livelihood." Taxpayers explain:

> The conclusion is wrong because the taxpayer also relied on his spouse's teaching occupation to help maintain his livelihood and built up his savings from his prior occupation of "Financial Analyst."

In addition, Taxpayers point out that the LOF erroneously cited "slot machines" as the source of Taxpayers' winnings. In fact, Taxpayers explain that husband's occupation is that of "Professional Poker Player."

Taxpayers emphasize that they had previously provided a 2019 "general activity log" and a "detailed general ledger." Taxpayers' conclusion is that husband "was a professional gambler, specializing in the high skills and profitable business of Poker Playing."

E. Analysis and Conclusion.

Taxpayers argue that the Department should not have "mocked" them because they only won $15,000 playing poker games but rather the Department should have "commended" them for their relative success at the poker table. Moreover, Taxpayers point out husband gave up his successful financial analyst career to devote himself to playing poker and that nowhere do the IRS regulations "provide for a dollar threshold that needs to be met in order to be deemed as 'showing a profit.'"

The Department agrees; if the Department's original LOF intimated that husband should be "mocked" for his gambling activities, then the Department would have been wrong to do so. However, the Department points out that there is nothing in the LOF which could reasonably be interpreted as "mocking" Taxpayers' or husband's career choices. The Department further agrees that the IRS regulations do not set a dollar threshold in determining whether or not an individual taxpayer is or is not entitled to report his or her income as that of a professional gambler.

The Department cites to *C.I.R. v. Groetzinger*, 480 U.S. 23 (1987) for authoritative guidance in addressing this matter. In that case, the Court relied on the long-held principle that resolution of the matter "requires an examination of the facts in each case." *Id.* at 36 (citing to *Higgins v. Commissioner of Internal Revenue*, 312 U.S. 212, at 217 (1941). Such an examination requires an application of the standard that "to be engaged in a trade or business, the taxpayer must be involved in the activity with continuity and regularity and that the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify." *Groetzinger*, 480 U.S. 480 at 35.

Considering the information and explanation provided by Taxpayers, the Department continues to conclude that Taxpayers have not met their statutory burden of establishing that husband played poker for the purpose of making a profit and sustaining their livelihood. As explained in the original LOF, Taxpayers have not provided a written business plan or developed business strategies which could be used to support their assertion that they could earn a living betting their money at a poker table. Taxpayers have not provided evidence that they engaged in "extensive study" to improve their odds by playing poker and thereby assure them of a viable income. As Taxpayers themselves point out, they relied on wife's income and husband's prior savings to sustain their livelihood.

Taxpayers failed to assert anything other than that they had a good faith belief that they can make a profit and maintain their livelihood by playing poker. However, any such a profit intention must be genuine, actual, if not reasonable. *Busch v. Commissioner of Revenue*, 713 N.W.2d 337 (Minn. 2006). Whether a taxpayer has an honest and objective intent is redetermined on a year-to-year basis. *Golanty v. Commissioner*, 72 T.C. 411, 425 (1979).

The Department remains unconvinced as to whether it is possible to have an actual and honest intention to make a profit playing poker at a gambling facility or that one can realistically rely on their $15,000 in poker winnings to maintain their livelihood. As the court explained by the United States Tax Court in *Ferguson v. C.I.R.*, T.C. Summ. Op. 2007-30, 2007 WL 610059 (Feb. 28, 2007):

> [S]imply spending all of one's free time on an activity does not transform that activity into a trade or business, nor does it make the participant a professional. Occasionally, devoting all of one's free time to a particular activity may be a sign of addiction. Further, the amount of time spent engaged in the activity is not the most significant aspect of the trade or business analysis. More important is the taxpayer's actual or honest objective of making a profit.

Taxpayers have not met their burden under IC § 6-8.1-5-1(c) of establishing that the Department's assessment

was wrong. There is insufficient evidence to establish that Taxpayers played poker and maintained business-like records - such as travel documentation, gambling log or diary, hotel charges, cash credit card advances, bank withdrawals, casino statements, poker study courses - in a "businesslike manner." Taxpayers have not established that they prepared to play poker by undertaking "extensive study," or that they had an actual and realistic expectation that playing poker and winning $15,000 could reasonably be relied upon to provide their livelihood.

After weighing the relevant factors set out in the federal regulation, the Department must again decline to sustain Taxpayers' protest.

FINDING

Taxpayers' protest is respectfully denied.

June 4, 2021

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An html version of this document.